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No. 75-1771

IN THE

Supreme Court of the United States

OCTOBER TERM, 1976

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

v.

STANDARD LIFE & ACCIDENT INSURANCE COMPANY,
Respondent.

On Writ of Certiorari to the United States
Court of Appeals for the Tenth Circuit

MOTION FOR LEAVE TO FILE BRIEF AMICUS CURIAE, WITH BRIEF ATTACHED, AND SUGGESTION OF LACK OF JURISDICTION

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MOTION FOR LEAVE TO FILE BRIEF AMICUS CURIAE

Amicus curiae, Tax Analysts and Advocates, respectfully requests this Court, pursuant to Rule 42, to allow it to file the attached Brief Amicus Curiae in this case. This brief argues, contrary to the position advanced by Standard Life, that deferred and uncollected premiums are not part of life insurance reserves and cannot be reported as such for federal tax purposes. In addition, contrary to the position advanced by the Government, this brief argues that the

Internal Revenue Code does not permit an election to include amounts in "life insurance reserves" when such amounts are not in fact reserves.

The brief also suggests that the Government's attempt to use its brief in this case to achieve a compromise settlement with the insurance industry, through provision of an election not authorized by statute, prevents this case from being presented in a fully adversary context. Given that fact, it appears that the Court may lack jurisdiction to consider the Government's proposed settlement, under which the Commissioner would accept the insurance industry's fictional assumption of full premium payment and consequent overstatement of reserves as long as the same assumption is consistently applied in computing other elements of the tax formula.

Because this brief does not support either party before the Court, it appears that the only portion of Rule 42(2) and (3) which is applicable is the statement that "A brief of an amicus curiae in cases before the court on the merits may be filed only after order of the court. . . ." The following information is nevertheless supplied for the convenience of the Court, as if this brief supported one or the other party:

a. *Interest of the Amicus Curiae.* The amicus curiae is a public interest tax law firm, which seeks to represent the interests of ordinary taxpayers before the Executive Branch and in the courts. Among other things, it opposes the shifting of tax burdens which takes place when erroneous or illegal interpretations of the tax law relieve certain taxpayers, such as the members of the life insurance industry, of tax burdens which must then be paid by others.

The amicus curiae believes that the government's position in the present case fails to defend the interests of ordinary taxpayers adequately. More specifically, it appears that the Government's position will result in revenue losses of $300 million or more, due to an erroneous interpretation of the provisions of the Life Insurance Company Income Tax Act of 1959. These losses will have to be recouped through higher tax payments by others, either immediately or, in the longer run, through higher service charges on an enlarged national debt.

The amicus also believes that it is important to present cases for judicial consideration in a fully adversary context, in accordance with the dictates of Article III of the Constitution. Since the nonadversary nature of the Government's proposed settlement of the deferred and uncollected premium issue may be obscured by the factual and legal complications surrounding this proceeding, the amicus is filing this brief to suggest the likelihood that the Court may lack jurisdiction, to the extent that the Government seeks to use its brief to propose a settlement not authorized by statute.

b. *Reasons Why the Parties' Presentation of the Facts and Law is Inadequate.* At the time the Treasury Regulations were promulgated under the Life Insurance Company Income Tax Act of 1959, and during the initial litigation of the deferred and uncollected premium issue (including the lower court proceedings in the instant case), the Government erroneously assumed (1) that net deferred and uncollected premiums were actually a portion of an insurer's life insurance reserves, and (2) that the annual statement form prescribed in all states provided for an accrual of the deferred and uncollected premiums. It was not until the trial judge's decision in *Monumental Life*

Insurance Co. v. United States, 76-2 U.S.T.C. ¶9787 (Ct. Cl.), filed November 19, 1976, that the courts recognized the Government's error. In that case, the trial judge pointed out that net deferred and uncollected premiums are not actually insurance reserves, and that the accounting on the annual state insurance statement is designed to totally eliminate their impact upon the company's financial position.

However, because four circuits have upheld the Government's regulations that erroneously included net deferred and uncollected premiums in reserves, the Government apparently refuses to recognize its error. Instead, in its brief in the present case, it has merely corrected its presentation of the facts to indicate, in conformity with the facts demonstrated in *Monumental Life*, that the net deferred and uncollected premiums are *not* actually reserves and that the annual statement does not, in any way, accrue them.

In addition, however, the Government has advanced the novel suggestion that a life insurance company has the choice of including or excluding net deferred and uncollected premiums from reserves. If the Court adopts this position, the Government's prior errors will not be exposed and corrected, but will be effectively obscured and perpetuated.

Life insurance companies will be financially benefitted by the inclusion of net deferred and uncollected premiums in reserves for tax purposes. Hence, they cannot be counted on to present the contrary point of view, and the facts supporting that view. Meanwhile, the Government appears wedded to its erroneous regulations, which permit the inclusion. Accordingly, the amicus curiae is filing this brief to assure presentation of the facts and law in an adversary context, and to protect the interest of ordinary taxpayers.

c. *Consents.* Neither party consents to the filing of this brief. In this connection, counsel for Standard Life states that he declines to consent unless the Court gives leave to file a response within 30 days to the questions presented herein.

Respectfully submitted,

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BRIEF FOR TAX ANALYSTS AND ADVOCATES AS AMICUS CURIAE

QUESTIONS DISCUSSED BY AMICUS CURIAE

1. Whether net deferred and uncollected premiums, which are universally admitted to be an overstatement of legally required insurance reserves, are nevertheless includable in "life insurance reserves" for tax purposes, as defined by Section 801(b) of the Internal Revenue Code of 1954 (as amended)?

2. Whether the Commissioner, even though deferred and uncollected premiums are not "life insurance reserves" within the scope of Section 801(b) of the Internal Revenue Code, may nevertheless permit a life insurance company to include them in reserves for tax purposes?

3. Whether the Government's proposed compromise settlement of the deferred and uncollected premium issue is presented to this Court in an adversary context, so as to constitute a "case or controversy" within the scope of Article III of the Constitution?

INTEREST OF THE AMICUS CURIAE

The amicus curiae is a public interest tax law firm, founded in 1970. It seeks to represent the interests of ordinary taxpayers before the Executive Branch and in the courts. Among other things, it opposes the shifting of tax burdens which takes place when erroneous or illegal interpretations of the tax law relieve certain taxpayers, such as the members of the life insurance industry, of tax burdens which must then be paid by others.

The amicus curiae believes that the Government's position in the present case fails to defend the interests of ordinary taxpayers adequately. More specifically, it appears that the Government's position will result in revenue losses of $300 million or more, due to an erroneous interpretation of the provisions of the Life Insurance Company Income Tax Act of 1959. These losses will have to be recouped through higher tax payments by others, either immediately or, in the longer run, through higher service charges on an enlarged national debt.

At the time the Treasury Regulations were promulgated under the Life Insurance Company Income Tax Act of 1959, and during the initial litigation of the deferred and uncollected premium issue (including the lower court proceedings in the instant case), the Government erroneously assumed (1) that net deferred and uncollected premiums were actually a portion of an insurer's life insurance reserves, and (2) that the annual statement form prescribed in all states provided for an accrual of the deferred and uncollected premiums. It was not until the trial judge's decision in *Monumental Life Insurance Co. v. United States*, 76-2 U.S.T.C. ¶9787 (Ct. Cl.), filed November 19, 1976, that the courts recognized the Government's error. In that case, the trial judge pointed out that net deferred and uncollected premiums are not actually insurance reserves, and that the accounting on the annual state insurance statement is designed to totally eliminate their impact upon the company's financial position.

However, because four circuits have upheld the Government's regulations that erroneously included net deferred and uncollected premiums in reserves, the Government apparently refuses to recognize its error. Instead, in its brief in the present case, it has merely corrected its presentation of the facts to indicate, in conformity with the facts demonstrated in *Monumental Life*, that the net deferred and uncollected premiums are *not* actually reserves and that the annual statement does not, in any way, accrue them.

In addition, however, the Government has advanced the novel suggestion that a life insurance company has the choice of including or excluding net deferred and uncollected premiums from reserves. If the Court adopts this position, the Government's prior errors will not be exposed and corrected, but will be effectively obscured and perpetuated.

Life insurance companies will be financially benefited by the inclusion of net deferred and uncollected premiums in reserves for tax purposes. Hence, they cannot be counted on to present the contrary point of view, and the facts supporting that view. Meanwhile, the Government appears wedded to its erroneous regulations, which permit the inclusion. Accordingly, the amicus curiae is filing this brief to assure presentation of the facts and law in an adversary context, and to protect the interest of ordinary taxpayers.

FACTUAL BACKGROUND

1. The Government's brief (Br. 32) correctly describes life insurance reserves as a calculation of projected liabilities established as a measuring device to determine the assets that the company must maintain in order to meet its future commitments under the policies it has issued. This is in accordance with the *prospective* definition of life insurance reserves contained in the Standard Valuation Law in effect in all states (*see, e.g.*, 26 Oklahoma Statutes Annotated, Section 1510(E)(2) (1958)), which states, in part, that

> * * * reserves for the life insurance and endowment benefit policies providing for a uniform amount of insurance and requiring the payment of uniform premiums shall be the excess, if any, of the present value, at the date of valuation, of such future guaranteed benefits provided by such policies, over the then present value of any future modified net premiums therefor.

Under this prospective view, the reserve represents the amount that the company must have in hand in its assets at the present time, to cover the difference between what

it will pay out in future benefits over what it will receive in future net premiums. Each payment of a premium reduces the amount of future net premiums that the company anticipates will be received to help finance the payment of future claims, and the company must correspondingly increase its reserve.

When a premium has not yet been paid, whether it is a future annual premium or a deferred or uncollected premium, it does *not* increase the reserve, because the currently unpaid premium is a premium that must be paid in the future to keep the contract in force and will, when paid, defray the cost to the company of future benefits. The company does not presently have to constrain its own assets to insure that it will have sufficient resources to pay future claims. Consequently, under the Standard Valuation Law, the net deferred or uncollected premiums cannot be included in the reserve, because they would overstate the company's actual liability and encumber an excessive portion of the company's assets.

Similarly, although not so described by state statute, reserves are often viewed *retrospectively* as being equivalent to the amount of net valuation premiums paid by the group of insureds, plus interest at the assumed rate, less assumed death claims for the group. Since the net valuation premiums are established at the inception of the policy in exactly the amount needed to pay the future death claims prescribed by the assumed mortality tables, the reserves will be the same if calculated retrospectively or prospectively. The amount assumed to remain in the company's assets from the prior premium payments under the retrospective calculation will always be equal to the amount the company anticipates it must have in assets in order to cover the difference between

the future benefits it will pay out and the amount it will receive in future net premiums. As in the case of the prospective calculation under the prospective view, the deferred or uncollected gross contract premiums have not yet been received and, consequently, the net portion thereof would not be included in the reserves, because it has not yet gone into the company's assets.

2. From a conceptual standpoint, too, without reliance on the prospective definition contained in the governing state statutes or on the equivalent retrospective calculation, net deferred and uncollected premiums are not considered to be reserves. As both the Government's brief (Br. 32) and the trial judge's opinion in *Monumental Life Insurance Co. v. United States*, 76-2 U.S.T.C. ¶9787 (Ct. Cl.), filed November 19, 1976, indicate, a reserve represents an estimate of the company's liabilities to its policyholders, and the company simply does not have an existing risk exposure or other liability in connection with a deferred or uncollected premium. If a policyholder dies during the 31-day grace period when the policy is still in force, the state statutes permit the company to deduct the uncollected premium from the policy proceeds. *See, e.g.*, 36 Oklahoma Statutes Annotated, Section 4003 (1958). Where the premium is deferred, rather than due and uncollected, and the insured dies, the insurer, typically, will also deduct the deferred premium from the policy proceeds. From a conceptual standpoint, therefore, the basic policy reserves in either case should not include any amount to represent a liability (which does not in fact exist) with respect to the premiums that remain unpaid at the death of the insured.

Similarly, in the event the policyholder fails to pay the deferred or uncollected premium when due, or within the grace period permitted by law, the insurer would nevertheless

not have any liability with regard to it. Upon the lapse of the policy, state law requires the company to credit the cash surrender value to the account of the policyholder. The cash surrender value is calculated on the basis of premiums actually paid to the date of the lapse. *See, e.g.*, 36 Oklahoma Statutes Annotated, Section 4029H (1958).

It is only because the insurer has *not* actually incurred a liability with respect to deferred and uncollected premiums that the state insurance commissioners not only permit, but uniformly require, that the apparent liability be cancelled through an offsetting entry in assets, as more fully described below. At the heart of the present controversy is the method by which life insurance companies compute these offsetting entries and their life insurance reserves and report them on the annual statement of the National Association of Insurance Commissioners (NAIC).

In calculating reserves, insurance companies have traditionally indulged in a fictitious assumption. Through a series of related and offsetting entries, companies first introduce and then neutralize an assumption of full annual premium payment. Under this assumption, the premiums on all of the ordinary life policies currently outstanding are considered to have been paid up one year in advance on each policy's issuance date and on each anniversary date thereafter, even though a portion of these premiums may be deferred or uncollected. The fiction that the deferred and uncollected premiums have been prepaid is reflected on the balance sheet by including the net valuation portion of such premiums on the liability side in the figure entitled "Aggregate reserve for life policies and contracts." A companion entry is then made adding an equivalent amount to assets. From a solvency standpoint, the net effect of this exercise is absolutely nil,

since the amount of real assets charged with responsibility for meeting the insurer's actual liability for policyholder benefits remains exactly the same. *Monumental Life Insurance Co., supra,* p. 85,553.

There is a similar system of related and offsetting entries made in the "Summary of Operations" schedule of the annual statement by which the life insurance company first introduces and then neutralizes the fictitious assumption that the premiums on all of the ordinary life policies have been paid up one year in advance on the policy's anniversary date. The gross deferred and uncollected premiums are first included in income, and are then offset by two separate deductions. The net valuation portion of the gross premiums included in income is partially offset by the inclusion of that amount in the overall deduction taken by the company for its increase in reserves. At that point, income is still overstated by the loading portion of the deferred and uncollected premiums. The remaining overstatement is offset by a further deduction called "Increase in loading on and cost of collection in excess of loading on deferred and uncollected premiums." *Monumental Life Insurance Co., supra,* p. 85,553. The net effect of this series of overstatements and offsetting adjustments in the "Summary of Operations" schedule (as in the balance sheet) is to totally eliminate any impact that the deferred or uncollected premium might have upon the life insurance company's financial statement.

The nature of the inclusion of the net deferred and uncollected premiums in the "Aggregate reserve" as constituting an overstatement of the company's actual life insurance reserves is not a subject of any controversy within the insurance industry. The text writers uniformly recognize the "Aggregate reserve" as an overstatement of the

actual reserve, and the inclusion in assets of the net deferred and uncollected premiums as a corrective offset to the overstatement of reserves. Wightman, *Life Insurance Statements and Accounts* 43-44, 155, 545 (1952 ed); MacLean, *Life Insurance* 318-319 (9th ed. 1962); Ernst & Ernst, *GAAP* [Generally Accepted Accounting Principles]-*Stock Life Companies* 449-450 (1974); Beardsley, *Life Company Annual Statement Handbook* III-15 (1962).

4. As the Government's brief (Br. 34-35) discloses, the practice of overstating the reserves and then offsetting them in the company's financial statements is an historic practice adopted by the First Session of the National Insurance Convention in 1871. *See, Official Report of the Proceedings of the National Insurance Convention of the United States* (1871), pp. 68-70. Although the life insurance companies have always had the capability of determining the exact reserve for each policy by taking into account the net portion of premiums actually paid to the December 31 reporting date, the actuarial work involved in making such a computation for each policy was considered "burdensome," and the Convention's Report prescribed the substitute method of overstatement and offset as bringing "substantially the same result." At that time, most of the ordinary life policies were paid by full annual premium on or before the anniversary date. For simplicity, it was therefore assumed that *all* policies were paid by full annual premium in this fashion. This, of course, produced an overstatement of reserves with respect to the policies on which there were deferred or uncollected premiums outstanding. That overstatement was then corrected by the creation of an artificial offsetting "asset." The *Official Report* termed this amount a "quasi-asset," and made it clear that it was included in assets only as an offset to the overstatement in the reserves. It was to

be regarded as a reduction in the "apparent liability [reserve] of the company as charged on the opposite side of the account" and "should not be for any other purpose regarded as an asset of any value."

Why the report did not recommend actually reducing the overstatement of the reserves in liabilities instead of entering corrective offsets in assets is unexplained, but it was made clear from the outset that the figure entered in assets was part of the reserve, rather than asset, valuation. Consequently, as the report and the above-cited text authorities indicate, the company's reserves are reflected in two items entered in the annual statement, not merely the figure shown in liabilities as the "Aggregate reserve." The amount entered in assets as the net deferred and uncollected premiums *is actually a reduction item* in the calculation of the reserves which must be taken into account by being subtracted from the "Aggregate reserve" when determining the company's actual life insurance reserves.

ARGUMENT

I. DEFERRED AND UNCOLLECTED PREMIUMS ARE NOT PART OF AN INSURER'S LIFE INSURANCE RESERVES AND CANNOT BE REPORTED AS LIFE INSURANCE RESERVES FOR TAX PURPOSES.

Section 801(b)(1)(B) of the Internal Revenue Code of 1954 (as amended) defines the term "life insurance reserves" in part, as meaning amounts "which are set aside to mature or liquidate * * * future unaccrued claims." Section 801(b)(2) further requires that "life insurance reserves must be required by law." Given these requirements,

it should be a simple matter to conclude that deferred and uncollected premiums do not qualify as life insurance reserves. They are not amounts "set aside," a phrase which would appear to require that reserves be derived from premiums already paid by the policyholders, as this Court has determined in the past.* This view of the Court apparently coincides with the retrospective calculation of reserves, which treats reserves as having derived from the prior payment of premiums.

Furthermore, deferred or uncollected premiums do not relate to "future unaccrued claims," as required by the Internal Revenue Code, since the company does not incur any liability with regard to them, as discussed earlier. *See, Monumental Life Insurance Co. v. United States,* 76-2 U.S.T.C. ¶9787 (Ct. Cl.), filed November 19, 1976. Finally, they are not life insurance reserves "required by law," because they represent an admitted overstatement of those reserves within the definition of the Standard Valuation Law and as reserves are universally understood in the insurance industry.

Nor is there any justification for including the net deferred and uncollected premiums in reserves because of the treatment given them on the annual statement. Section 818(a)(1) of the Code requires that all computations be made under an accrual method of accounting, and the NAIC annual statement method of entering overstatements

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* *See, e.g., New York Life Ins. Co. v. Edwards,* 271 U.S. 109, 115, 119 (1926); *New York Life Ins. Co. v. Bowers,* 283 U.S. 242, 244 (1931); *Helvering v. Inter-Mountain Life Insurance Co.,* 294 U.S. 686, 690 (1935); *Williams v. Union Central Life Insurance Co.,* 291 U.S. 170, 177 (1934); *United States v. Atlas Life Ins. Co.,* 381 U.S. 233, 247 (1965).

and corrective offsets is not such an accrual method. Moreover, Section 801 defines reserves without reference to the amounts shown in the annual statement and, further, without reference to any overstatement of the reserves. Similarly, Section 805(b)(4) defines "assets" without reference to the annual statement as "assets of the company" – clearly suggesting that the reference is to *real* assets, not "quasi-assets" that are merely corrective offsets to reserve overstatements. *See, Official Report of the Proceedings of the National Insurance Convention of the United States* (1871), *supra,* pp. 68-70. Even though there is a conflict between the Tenth Circuit in this case and decisions in four other circuits, one item on which they *all* agree is that the NAIC annual statement should not be followed to the exclusion of the definitional sections of the Internal Revenue Code relating to "assets" and "reserves."

Perhaps a conclusive indication that Congress rejected the NAIC method of overstating, and then correcting, the reserves is the omission from Section 809(d) of any deductions relating to the increase in loading on deferred and uncollected premiums. This deduction in the NAIC annual statement is a necessary and integral part of the entire system of introduction and neutralization of the overstatement in reserves. Congress has provided specific deductions pertaining to life insurance in Section 809(d) (*see,* in particular, subsections (1) - (3)), and it would hardly have omitted such a prominent deduction if it had intended to carry over to the tax return the mechanics of the NAIC annual statement treatment.

Furthermore, in view of the purpose of the Phase I tax computation, it is unlikely that Congress would have desired to include the net deferred and uncollected premiums in reserves. In the Phase I computation of taxable investment income, the larger the figure used for reserves,

the larger will be the share of investment income attributed to policyholders and therefore not taxed to the company. But because of the additional premiums charged a policyholder to put his premiums on a fractional mode of payment, and because of a similar charge permitted under state statute with regard to recovering an uncollected premium, the insurer is not obligated to appropriate any part of the income generated by its own investments to provide an investment return on deferred and uncollected premiums. "The standard policy provisions require that return to come from the pocket of the policyholder whenever he pays such a premium and thereby keeps his coverage in force." *Monumental Life, supra,* p. 85,552. In that respect, the trial judge in *Monumental Life* concluded as follows:

> Since, as earlier explained, investment return on deferred and uncollected premiums is obtained directly from the policyholder's pocket by subjecting him to an additional interest charge, the insurer's reservoir of investment income need not be drained in order to provide a commensurate return on assets exposed to coverages represented by such premiums. * * * Thus, no element of those premiums has any proper place in either the numerator or the denominator of the Phase I fraction whose assigned function is ascertainment of that portion of total investment income needed to provide a return on those assets that are reserved for the payment of the future policyholder claims. (*Id.*, p. 85,557).

If the net deferred and uncollected premiums must be included in reserves, there would clearly be less of a distortion in investment income if a somewhat greater (rather

than equal) amount were also included in assets. This procedure would tend to minimize the unwarranted attribution of the insurer's investment yield to policyholder liability requirements. However, in the absence of any compelling reason why net deferred and uncollected premiums should be included in reserves in the first instance, totally eliminating the distortion by excluding deferred and uncollected premiums from the tax computation is preferable to only lessening the distortion by including a greater amount in assets.

There is no justification to the Government's contention in its *Standard Life* brief (Br. 41) that including the deferred and uncollected premiums in full in assets produces an "accurate result," when it merely *lessens* the distortion in investment income. Nor is the Government justified in contending (Br. 56) that the "alternative approach" of excluding those premiums completely from the tax formula does no more than "guarantee the integrity of the tax computations." The fact is that completely excluding the deferred and uncollected premiums is the *only* method of producing an accurate result in the Phase I computation.

Had the courts in the earlier cases not mistakenly believed that net deferred and uncollected premiums are a part of the life insurance reserves, there is a strong likelihood that they would have required the exclusion of deferred and uncollected premiums from the Phase I tax computation. We can be reasonably certain that this would have been the result in the Tax Court and in the Fifth Circuit.

In his original decision in *Western National Life Ins. Co. v. Commissioner,* 50 T.C. 285 (1968), Judge Drennen excluded the deferred and uncollected premiums in their entirety from assets and suggested their elimination from

reserves pursuant to Treasury Regulations Section 1.801-4(f), despite his erroneous belief, based upon the submissions of the parties, that the net deferred and uncollected premiums are part of the life insurance reserves. On rehearing, after the parties (and the life insurance trade associations appearing as *amici curiae*) insisted that deferred and uncollected premiums must be included in life insurance reserves, he agreed to that inclusion and to the inclusion of an equal amount in assets. 51 T.C. 824. The Fifth Circuit reversed the Tax Court and upheld the Commissioner's position that, although only the net deferred and uncollected premiums are includable in reserves, the full gross amount of those premiums is includable in assets. 432 F.2d 298 (1970).

The Court based its opinion upon the mistaken view that "the life insurance industry either because of requirements of state regulating agencies or otherwise, universally considers these deferred and uncollected premiums as accrued at the end of the year" and, further, that there existed a "state commissioners' requirement that the policyholder's share [the net valuation portion of the deferred and uncollected premium] be accrued and added to reserves even though not legally collectable." 432 F.2d, at 300.

That the Fifth Circuit would have eliminated deferred and uncollected premiums completely from the tax computation – had it been aware that they were *not* considered as accrued in the annual statement and were *not* part of the reserves under state law – is evidenced by the next case decided by that Circuit involving deferred and uncollected premiums. In *Great Commonwealth Life Ins. Co. v. United States,* 491 F.2d 109 (5th Cir. 1974), the Court was faced with the question of whether, once the deferred

and uncollected premiums are treated as fully accrued in the balance sheet for Phase I purposes as determined in *Western National Life Ins. Co., supra,* they also must be accrued in income for Phase II purposes. The Court held that they must be fully accrued for Phase II purposes, but that the company should be entitled to a deduction for the agent's commissions that will be incurred upon payment of the deferred and uncollected premiums. In so holding, however, the Court stated (p. 116) as follows:

> The result we reach is admittedly an imperfect one. None of the amounts under discussion are properly accruable under normal accounting practices. It would be far more accurate, we think, for the company to disregard deferred and uncollected premiums for all tax purposes, with the Commissioner's approval, of course, Section 446 (e); Treas. Reg. Sec. 1.446-1(e). This would create some variance of accounting between the N.A.I.C. reports and the tax returns, but it is well settled that there is no necessary agreement between the two, as noted by the Courts in *Franklin Life [Insurance Co. v. United States,* 399 F.2d 757 (C.A. 7), certiorari denied, 393 U.S. 1118], *Jefferson Standard Life [Insurance Co. v. United States,* 408 F.2d 842 (C.A. 4), certiorari denied, 396 U.S. 828] and *Western National Life* [*supra*]. We hold only that, once the company accrues the net valuation portion of the deferred and uncollected premiums, it must accrue the gross amount of those premiums for all tax purposes, and that it is also entitled to accrue commissions payable on those premiums.

Obviously, because the Court had already decided in *Western National* that there should be an accrual of deferred and uncollected premiums in the Phase I computation (based upon the erroneous assumptions that they were accrued in the annual statement and included in reserves pursuant to state requirements), the Court extended that holding to Phase II, even though it would have preferred to disregard the deferred and uncollected premiums for all tax purposes.

The above-quoted portion of the *Great Commonwealth* opinion indicating the Court's dissatisfaction with including deferred and uncollected premiums in the tax computations, subsequently was quoted with approval by the Tax Court in *Bankers Union Life Ins. Co. v. Commissioner,* 62 T.C. 661, 675 fn. 5 (1974). Nevertheless, the Tax Court reluctantly held that the deferred and uncollected premiums must be accrued because four circuits had previously so held, and the court "recognized its obligation to promote uniform application of the internal revenue laws" (62 T.C. at 675).

In *Standard Life,* the Supreme Court is not faced with its own prior erroneous decision, as was the Fifth Circuit in *Great Commonwealth, supra,* nor with the prospect of promoting an unequal application of the laws, as was the Tax Court in *Bankers Union.* Consequently, based upon a full understanding of the state statutory requirements and standard insurance accounting, the Court should reject "imperfect" results and should eliminate deferred and uncollected premiums completely from life insurance company tax computations.

II. NEITHER THE COMMISSIONER NOR THE TAXPAYERS HAS AN ELECTION TO INCLUDE AMOUNTS IN "LIFE INSURANCE RESERVES" AS DEFINED IN SECTION 801 (b) OF THE INTERNAL REVENUE CODE WHEN SUCH AMOUNTS ARE NOT IN FACT RESERVES.

In its first argument heading (Br. I), the Government proposes inclusion of gross deferred and uncollected premiums in "assets" and in the "gross amount of premiums" in cases in which "A life insurance company * * * includes the net valuation portion of deferred and uncollected premiums in 'reserves'." Thus, the Government in effect suggests handling deferred and uncollected premiums as though insurance companies had an election to include or exclude these premiums from reserves when computing their federal income taxes. But Congress has not provided an election of this sort.

Similarly, the Government concludes its brief (Br. 57) with a statement that "despite the logic and simplicity of total exclusion of deferred and uncollected premiums, the Commissioner is willing to accept the life insurance industry's fictional assumption of full premium payment and consequent overstatement of reserves as long as the same assumption is consistently applied in computing the other elements of the tax formula." But the Commissioner lacks statutory authorization to make a "deal" of this sort with the insurance industry.

We have not been able to locate any prior instance in the extensive litigation involving the deferred and uncollected issue in which the Government has offered the taxpayer an election to include or exclude deferred and uncollected premiums from reserves, provided that taxpayers report them in assets and income in accordance with the Government's stated positions. There is, however, no

justification for such a choice under the statute or the Government's own regulations. Only reserves "required by law" can be claimed as life insurance reserves for tax purposes. Section 801(b)(2) of the Code; Treasury Regulation Section 1.801-4(a)(3). Since net deferred and uncollected premiums are *not* reserves required by law, neither a life insurance company nor the Commissioner can choose to treat them as reserves in contravention of the statute.

Although the Treasury Regulations state alternative positions with regard to the treatment of deferred and uncollected premiums (see Treasury Regulation Section 1.801-4(f), the alternatives do not authorize an election, but merely express the Treasury's uncertainty with regard to the proper treatment. As Treasury Regulation Section 1.801-4(f) indicates, "In the event it is determined * * * that premiums deferred and uncollected and premiums due and unpaid are not properly accruable for the taxable years * * * and are not properly includable under assets * * * for the taxable year, appropriate reduction *shall* be made in the life insurance reserve." (Emphasis supplied). Since deferred and uncollected premiums are not properly accruable, are not properly includable under assets, and are not actually life insurance reserves, the "appropriate reduction shall be made" to exclude them from reserves if the taxpayer had erroneously included them in reserves in the first instance. The Commissioner, as well as the taxpayer, is required to abide by these regulations.

Although it is true that a taxpayer may "strengthen" its reserves by changing the mortality and interest assumptions upon which they are based (*see*, Section 810(d) of the Code), overstating reserves and entering a corresponding offset in assets does not effect a strengthening. The

reserves remain the same as if no overstatement had been made, since the overstatement constrains no additional assets of the company and does not constitute a reserve.

In its brief for this Court, the Government seeks to treat the deferred and uncollected premium question as if it were only a matter of "logic and simplicity," rather than a matter involving a statutory command. *See, e.g.*, Br. 34, 57. On this basis, the Government seeks to dismiss the *Monumental Life* opinion as offering simply one among many possible solutions to the deferred and uncollected premium problem.

But *Monumental Life* is based on more than what the Government terms (Br. 57) the "dual rationale of logic and simplicity." That opinion is also grounded firmly on the command of the Internal Revenue Code, which excludes deferred and uncollected premiums from reserves because they are not "life insurance reserves" (Section 801(b)(1)) or "required by law" (Section 801(b)(2)); from assets because they are not "asets of the company" (Section 801(b)(5)); and from the "gross amount of premiums" because the company has no right to them (Section 809(c)(1)). Furthermore, any inclusion of deferred and uncollected premiums would violate the accrual method required under Section 818(a).

The Government's position in the present case contrasts starkly with the rationale adopted in *Monumental Life.* Not only does the position urged by the Government lack "logic and simplicity," but it violates the explicit provisions of the Internal Revenue Code just as seriously as do the various positions urged by the life insurance companies.

In short, the Government's proposed election makes a hash of a carefully drafted statutory scheme. Only Congress can grant taxpayers in the insurance industry an election to disregard the provisions of Section 801(b) of the Internal Revenue Code, and the other Code sections cited above, by including items in reserves that are not in fact reserves "required by law." The Commissioner of Internal Revenue is not authorized to disregard the statutory command of the legislature by blithely and belatedly discovering an election provision where none exists.

III. THIS CASE IS NOT PRESENTED IN AN ADVERSARY CONTEXT TO THE EXTENT THAT THE GOVERNMENT SEEKS TO ACHIEVE A COMPROMISE SETTLEMENT OF THE DEFERRED AND UNCOLLECTED PREMIUM ISSUE.

As outlined above, the Government's brief indicates (Br. 57) that "the Commissioner is willing to accept the life insurance industry's fictional assumption of full premium payment and consequent overstatement of reserves as long as the same assumption is consistently applied in computing the other elements of the tax formula." For the reasons outlined in the previous section of this brief, the amicus curiae believes that there is no statutory authorization for this proposal.

In addition, however, this attempt by the Government to achieve a compromise settlement with the insurance industry raises questions about the adversary nature of the proceedings in this case. This Court has a right to expect that the parties before it will present the strongest arguments that can legitimately be made in support of their respective positions. But the Government's

attempt to use its brief as a means of achieving a compromise with the life insurance industry prevents this case from being argued in a fully adversary context.

The nonadversary nature of these proceedings is further shown by the Government's failure to adopt and support the interpretation of the Internal Revenue Code adopted in the *Monumental Life* case, *supra.* The legal rationale adopted in that case is clearly the strongest litigating position that can be advanced by the Government before this Court. But, inexplicably, the Government has failed to adopt it, even though the Government *has* revised its presentation of the facts to comport with the findings in *Monumental Life.*

These facts raise questions as to whether this case presents a "case or controversy" within the meaning of Article III of the Constitution. *Moore v. Charlotte-Mecklenberg Board of Education,* 402 U.S. 47 (1971). Where parties before a court urge the same solution to a problem, the case does not present a question "in an adversary context" as required by the Constitution. *Flast v. Cohen,* 392 U.S. 83, 95 (1968). Accordingly, to the extent that the Government seeks in this case to achieve a compromise settlement of the deferred and uncollected premium issue, it appears that this Court may lack jurisdiction to consider the Government's proposal.

CONCLUSION

For the reasons stated above, the judgment of the Court of Appeals should be reversed and judgment entered based on the reading of the Internal Revenue Code adopted in *Monumental Life Insurance Co. v. United States, supra.*

Respectfully submitted,

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